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Nos. 71-777 and 71-807

In the Supreme Court of the United States

OCTOBER TERM, 1971

ROBERT E. CLEVELAND AND FRANCES H. CLEVELAND, PETITIONERS

v.

ILLINOIS BELL TELEPHONE COMPANY, AN ILLINOIS CORPORATION, AND UNITED STATES OF AMERICA

ROBERT C. AGRON, PETITIONER

v.

ILLINOIS BELL TELEPHONE COMPANY AND UNITED STATES OF AMERICA

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The opinion and order of the district court in No. 71-777 (Pet. App. 24a-29a) are unreported. The two opinions of the district court in No. 71-807 (Pet. App. 18a-26a) are reported at 319 F. Supp. 418 and 325 F.

Supp. 487. The opinion of the court of appeals in both cases (No. 71–777, Pet. App. 1a–15a; No. 71–807, Pet. App. 1a–17a) is reported at 449 F. 2d 906.

JURISDICTION

The judgments of the court of appeals were entered on September 22, 1971. The petitions for writs of certiorari were filed on December 11, 1971, in No. 71–777, and on December 18, 1971, in No. 71–807. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether petitioners may exclude from the base upon which the 10 percent federal tax on "amounts paid for * * * communication services", imposed by Section 4251 of the Internal Revenue Code of 1954, is computed, any part of the telephone rates authorized by Illinois law and charged and collected by Illinois Bell Telephone Company because those rates reflected operating costs including, among other items, increased state and municipal taxes imposed upon and collected from the telephone company.

2. Whether petitioners may maintain class actions for refunds of unstated amounts of federal taxes to unnamed and unidentified taxpayers who have not filed the claims for refund required by Section 7422(a) of the Internal Revenue Code as a prerequisite to the maintenance of a suit for the recovery of any internal revenue tax.

STATUTES INVOLVED

Sections 4251(a), 4252 (a) and (b), and 4254 (a) and (b) of the Internal Revenue Code of 1954 are set forth

in the Appendix to the petition in No. 71–807 (pp. 27a–28a). Pertinent sections of the Illinois statutes are set forth in the Appendix to the brief in opposition of respondent Illinois Bell Telephone Company (pp. A1–A6). Sections 6402(a) and 7422(a) of the Internal Revenue Code of 1954 are set forth in the Appendix, *infra*, p. 13.

STATEMENT

Petitioners are residents of Chicago, Illinois, and are subscribers to telephone services supplied there by Illinois Bell Telephone Company ("Illinois Bell"), a public utility whose intrastate rates are regulated by Illinois law and the Illinois Commerce Commission. As telephone subscribers, petitioners are and have been subject to the tax at the rate of 10 percent imposed on "amounts paid for * * * communication services" by Section 4251 of the Internal Revenue Code. As provided therein, the tax is to be "paid by the person paying for the services"; but, as required by Section 4291, it is collected by Illinois Bell, and remitted to the United States.

For over thirty years, the State of Illinois has imposed upon persons engaged in various businesses, including public utilities, a number of "occupation taxes." One of these has been a tax "upon persons engaged in the business of transmitting messages," measured by "gross receipts from such business." Smith-Hurd Ill. Ann. Stat., c. 120, §§ 467.1, 467.2. In 1955,[1] the State authorized municipalities to tax (at rates not to exceed 5 percent of gross receipts

[1] 1955 Laws of Illinois, p. 1900. Approved July 14, 1955.

from intrastate service in the taxing municipality) the occupations of various public utilities, including that of "[p]ersons engaged in the business of transmitting messages by means of electricity * * *." Smith-Hurd Ill. Ann. Stat., c. 24, § 8–11–2. Since that time, over seventy Illinois municipalities, including the City of Chicago, have imposed occupation taxes at rates up to 5 percent upon Illinois Bell. At the same session, the Legislature, by statute approved the same day,[2] amended the basic utility regulatory statute (Smith-Hurd Ill. Ann. Stat., c. 111 2/3) by adding what is now § 36(a), authorizing a utility subjected to the municipal occupation taxes to charge its customers for intrastate service in the taxing municipality, in addition to any rate otherwise authorized, an additional charge equal to (1) the amount of the municipal tax, or any part thereof, (2) 3 percent thereof to cover accounting costs, and (3) an amount equal to the increase in taxes and other payments to governmental bodies resulting from the additional charge. Such an increase in rates was to be made as others were—by filing a supplemental schedule specifying the additional charge with the Illinois Commerce Commission. The additional charge was to be shown separately on the utility bill to customers. The Commerce Commission could investigate to determine whether the additional charge was within the statutory formula, and could order refunds if it was excessive, but otherwise could not suspend this statutorily authorized increase, as it could with other revised rate schedules proposing increases.

[2] 1955 Laws of Illinois, p. 3022. Approved July 14, 1955.

When municipalities have imposed the occupation tax measured by gross receipts from service within the municipality, Illinois Bell has usually filed supplemental schedules of rates pursuant to the authority of § 36(a) and has billed its customers within the municipality accordingly.

In 1965, the Legislature of Illinois increased the rate of the state occupation tax upon "persons engaged in the business of transmitting messages" from 3 percent to 4 percent [3] (and in 1967 to 5 percent), and at the same time further amended the utility regulatory statute by adding § 36(b),[4] which performed substantially the same function in authorizing an additional charge with respect to the increase in the rate of the state tax that § 36(a) had performed with respect to newly imposed municipal occupation taxes. Illinois Bell has paid the state tax at the increased rates, has filed with the Commerce Commission appropriate supplemental schedules, and has made and collected the additional charge authorized. Section 36(b) did not require that the additional charge authorized thereunder be separately indicated on bills to customers, as § 36(a) did. It appears, however, that Illinois Bell has shown the additional charge separately on bills.

Illinois Bell, in accordance with rulings issued by the Commissioner of Internal Revenue, has collected and remitted to the United States the federal tax imposed by Section 4251 of the Internal Revenue Code

[3] 1965 Laws of Illinois, p. 1684. Approved July 16, 1965.
[4] 1965 Laws of Illinois, p. 1679. Approved July 16, 1965.

upon "amounts paid for * * * communication services" by computing it upon "the sum of all charges for such services included in the bill," as required by Section 4254, including the additional charges authorized by § 36 (a) and (b) of the Illinois statute.

Petitioner Agron filed a claim for refund of the communication tax in the amount of $23.98, asserting that, for a period beginning in 1965 and through the first three quarters of 1968, the tax he had paid had been improperly computed by virtue of including in its base the additional charges billed by Illinois Bell. At the same time, petitioner Agron filed a purported claim for refund of communication tax in an unstated amount, allegedly on behalf of unspecified and unnamed taxpayers ("all other telephone subscribers of Illinois Bell Telephone Company who are situated similarly to him"). Both claims were denied, and suit on three counts against the United States and Illinois Bell was thereafter instituted, asserting: in Count I, a claim for $23.98 on behalf of petitioner individually; in Count II, a class action on behalf of unnamed taxpayers who had not filed claims for refund; and, in Count III, a purported derivative action seeking refund to Illinois Bell of taxes collected by it from its customers, and by it paid over to the United States. Illinois Bell was thereafter voluntarily dismissed as a defendant under Count I by petitioner. On cross motions for summary judgment, the district court entered judgment for petitioner for $23.98 under Count I, but dismissed Counts II and III. On cross appeals, the court of appeals

reversed the judgment for petitioner on Count I, and dismissed petitioner's appeals on Counts II and III.

In No. 71-777, without having filed any claim for refund, the petitioners Cleveland instituted a similar individual and class suit against Illinois Bell alone in a state court in Illinois, demanding also declaratory and injunctive relief. The suit was removed to the United States District Court by Illinois Bell, and peitioners' motion to remand was denied. The United States was thereafter added as a defendant. On motions of the defendants, the suit was dismissed by the district court, and its order was affirmed by the court of appeals.

ARGUMENT

The decisions below are correct. There is no conflict of decisions or any other basis for review by this Court.

1. Petitioners contest the increase in the federal tax on amounts paid for communication services resulting from an increase in telephone rates authorized by Illinois law. Since the federal tax is 10 percent of the sum of all charges for such services, an increase in telephone rates inevitably results in an increase in the federal tax. Petitioners' claim is therefore groundless. It is no more significant that the rate increase was occasioned by an increase in municipal and state taxes imposed upon the telephone company than it would have been if the rate increase had been occasioned by increased costs of labor or materials. This Court has recognized that taxes imposed upon utilities are costs that must be included in the utilities'

rate structures and recovered by charges to their customers. *Federal Power Commission* v. *United Gas Pipe Line Co.*, 386 U.S. 237, 243; *Georgia Railway & Power Co.* v. *Railroad Commission*, 262 U.S. 625, 632–633; *Galveston Electric Co.* v. *Galveston*, 258 U.S. 388, 399.

In an effort to avoid the inevitable conclusion that the federal tax was properly increased as the telephone company's rates increased, petitioners assert that the Illinois municipal and state occupation taxes upon the telephone company were in fact taxes upon the customers of the telephone company, and for that reason improperly included in the base of the federal tax. This, of course, is entirely a matter of Illinois law, and hardly calls for review by this Court. In any event, the same argument has in a number of contexts been rejected by the Supreme Court of Illinois both as a matter of statutory construction and as a matter of constitutional imperative under the Illinois constitution. *Reif* v. *Barrett*, 355 Ill. 104, 188 N.E. 889; *People's Drug Shop, Inc.* v. *Moysey*, 384 Ill. 283, 51 N.E. 2d 144; *Vause & Striegel, Inc.* v. *McKibbin*, 379 Ill. 169, 39 N.E. 2d 1006; *International Business Machines Corp.* v. *Department of Revenue*, 25 Ill. 2d 503, 185 N.E. 2d 257. And this Court similarly has held that the parallel Illinois occupation tax upon retailers, measured by gross receipts from sales to the United States, was not a tax upon the United States. *United States* v. *Department of Revenue*, 371 U.S. 21, affirming 202 F. Supp. 757 (N.D. Ill.).

Petitioners also stress that the additional charge (which was not the amount of the municipal and state

taxes, but a composite of factors) was separately stated on the telephone company's bills. But both the Illinois Supreme Court and this Court have held that the separate statement of a tax is of no significance in determining its incidence. See *Fischman & Sons, Inc.* v. *Department of Revenue*, 12 Ill. 2d 253, 146 N.E. 2d 54; *Alabama* v. *King & Boozer*, 314 U.S. 1; cf. *Wilmette Park Dist.* v. *Campbell*, 338 U.S. 411, 418. This Court, moreover, pointed out in *Lash's Products Co.* v. *United States*, 278 U. S. 175, 176, that:

> The phrase "passed the tax on" is inaccurate, as obviously the tax is laid and remains on the manufacturer * * *. The purchaser does not pay the tax. He pays or may pay the seller more for the goods because of the seller's obligation, but that is all. * * *

These observations constitute an effective answer to petitioners' claim that Illinois law, as they read it, reduces the base upon which the federal tax should be computed.[5] The economic impact of a tax upon a pro-

[5] Petitioners' arguments present but slight, if any, verbal variants upon arguments that have frequently and unsuccessfully, been advanced in state courts where the base upon which a sales or gross receipts tax is computed has been enlarged because an earlier tax, often separately stated, upon a manufacturer or distributor has increased the price of the goods. The Illinois decisions are: *Martin Oil Service, Inc.* v. *Department of Revenue*, 273 N.E. 2d 823; *Fischman & Sons, Inc.* v. *Department of Revenue*, *supra*; *People* v. *Werner*, 364 Ill. 594, 5 N.E. 2d 238. Similar decisions in other states, frequently citing *Lash's Products Co.* v. *United States*, *supra*, are: *Pure Oil Co.* v. *State*, 244 Ala. 258, 12 So. 2d 861; *Merchants Cigar & Candy Co.* v. *Birmingham*, 245 Ala. 587, 18 So. 2d 137; *Cass* v. *Colorado Beverage Co.*: 122 Colo. 101, 220 P. 2d 867; *Consolidated Distributors, Inc.* v. *City of Atlanta*, 193 Ga. 853, 20

ducer of goods or services of course ultimately falls upon a consumer in the form of increased rates or charges; but petitioners' arguments require a finding, rejected both by the Illinois courts and by the court of appeals, that the legal incidence of the Illinois state and municipal taxes was upon consumers.

2. Since the court of appeals rejected petitioners' contentions on the merits, it found it unnecessary to review the district court's decisions (in No. 71-807) that a class or derivative action could not be maintained on behalf of taxpayers who had filed no claims for refund, and (in No. 71-777) that petitioners could not maintain either an individual or a class action to recover federal taxes without having filed any claim for refund. The decisions of the district court were correct.

S.E. 2d 421, certiorari denied, 317 U.S. 662; *Undercofler* v. *Capital Automobile Co.*, 111 Ga. App. 703, 143 S.E. 2d 206; *State* v. *Ehoni Oil Magic Benzol Gas Stations, Inc.*, 121 Ga. App. 454, 174 S.E. 2d 244; *Sun Oil Co.* v. *Gross Income Tax Div.*, 238 Ind. 117, 149 N.E. 2d 113; *State ex rel. Byers-Prentboldt Motor Co.* v. *Minnesota Tax Comm.*, 179 Minn. 200, 227 N.W. 43; *Havens* v. *Attorney General*, 91 N. H. 115, 119, 14 A. 2d 636, 639; *Hoffman* v. *City of Syracuse*, 2 N.Y. 2d 484, 141 N.E. 2d 610; *F. & M. Schaefer Brewing Co.* v. *Gibson*, 14 N.Y. 2d 25, 197 N.E. 2d 291; *Lehman* v. *Grantham*, 78 N.C. 115; *Green Wood Co.* v. *Evatt*, 147 Ohio St. 461, 55 N.E. 2d 734; *S. & L. Strauss Beverage Co.* v. *Commonwealth*, 187 Va. 1055, 41 S.E. 2d 76. State courts have reached other results only where the taxing statute by its terms eliminated the amount of the prior tax from the computation of the tax in question (*Duplex Art Film* v. *State Tax Comm.*, 108 Utah 513, 161 P. 2d 788), or where the court found that the two taxing statutes imposed simultaneous taxes on the same transaction. *Fox Reelers Bd.* v. *Exp. Standard Div.*, 424 Pa. 355, 227 A. 2d 657. Cf. *Cunningham Drug Stores* v. *Viles*, 319 Mich. 467, 29 N.W. 2d 915, with *Standard Oil Co.* v. *State*, 283 Mich. 85, 276 N.W. 906.

Section 7422(a) of the Internal Revenue Code, Appendix, *infra*, p. 13, provides that "no suit or proceeding shall be maintained in any court" to recover internal revenue taxes "until a claim for refund * * * has been duly filed * * * according to the provisions of law in that regard, and the regulations of the Secretary or his delegate established in pursuance thereof." This Court has regularly held that the statute, as its terms indicate, makes a proper claim a pre-condition to suit, and is not to be circumvented or rendered ineffective. *Angelus Milling Co.* v. *Commissioner*, 325 U.S. 293; *United States* v. *Garbutt Oil Co.*, 302 U.S. 528; *United States* v. *Felt & Tarrant Co.*, 283 U.S. 269; *Collector* v. *Hubbard*, 12 Wall. 1. Treasury Regulations on Procedure and Administration, § 301.6402-2(a)(1) and (c) require that the claim be "by the taxpayer", and in (c) permit a claim executed by an agent only if accompanied by a power of attorney. As this Court pointed out in *United States* v. *Andrews*, 302 U.S. 517, the claim is required not only in order to state the merits of the matter—the Commissioner had independently given a ruling favorable to the taxpayers in that case—but also to permit audit to determine whether other taxes or debts are owing to the United States so that they may be set off as required by Section 6402 of the Internal Revenue Code, Appendix, *infra*, p. 13, and by this Court's decision in *Cherry Cotton Mills, Inc.* v. *United States*, 327 U.S. 536. An unauthorized and indefinite claim, purportedly on behalf of unnamed taxpayers for unstated amounts, therefore fulfills neither the terms nor the purposes of the statute and regula-

tions. And the filing of the simple claim for refund (Form 843) by individual taxpayers would involve certainly no more, and probably less, effort and difficulty than proving their individual entitlement in a district court in a class action. The Internal Revenue Service routinely makes thousands of refunds every year.

Rule 82 of the Federal Rules of Civil Procedure provides that the Rules do not enlarge the jurisdiction of the district courts, and this Court has held that Rule 23 with respect to class actions does not enlarge that jurisdiction. *Snyder* v. *Harris*, 394 U.S. 332. Two district courts that have considered the question have held that class actions may not be maintained to recover internal revenue taxes on behalf of taxpayers who have not filed claims for refund. *McDaniell* v. *United States*, 295 F. Supp. 605 (E.D. Tenn.); *Harkins* v. *United States*, 66-2 U.S.T.C. par. 9543 (E.D. Okla.), affirmed on other issues, 375 F. 2d 239 (C.A. 10). There is no authority to the contrary.

CONCLUSION

The petitions for writs of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1972.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 6402. AUTHORITY TO MAKE CREDITS OR REFUNDS.

(a) *General Rule.*—In the case of any overpayment, the Secretary or his delegate, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall refund any balance to such person.

* * * * *

SEC. 7422. CIVIL ACTIONS FOR REFUNDS.

(a) *No Suit Prior to Filing Claim for Refund.*—No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary or his delegate, according to the provisions of law in that regard, and the regulations of the Secretary or his delegate established in pursuance thereof.

* * * * *